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**In the Supreme Court of the United States**

**OCTOBER TERM, 1946**

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**No. 279**

**ABRAHAM KIRSCHENBAUM, PETITIONER**

*v.*

**COMMISSIONER OF INTERNAL REVENUE**

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**No. 280**

**HARRY BANNER, PETITIONER**

*v.*

**COMMISSIONER OF INTERNAL REVENUE**

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**ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED  
STATES CIRCUIT COURT OF APPEALS FOR THE SECOND  
CIRCUIT**

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**BRIEF FOR THE RESPONDENT IN OPPOSITION**

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**OPINIONS BELOW**

The opinion of the Tax Court of the United States (R. 169-173) is a memorandum opinion and therefore not officially reported. The opinion of the Circuit Court of Appeals (R. 213-217) is reported at 155 F. 2d 23.

(1)

**JURISDICTION**

The judgment of the Circuit Court of Appeals was entered on April 8, 1946. (R. 217-218.) The petition for a writ of certiorari was filed on July 5, 1946. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

**QUESTIONS PRESENTED**

1. Whether there was substantial evidence to support the decision of the Tax Court that a redemption of part of the corporation's stock was made at such time and in such manner as to make the distribution to the taxpayers essentially equivalent to the distribution of a taxable dividend within the meaning of Section 115 (g) of the Internal Revenue Code.
2. Whether, where a corporation purchased equal amounts of stock from its two stockholders and retained the shares as treasury stock under the circumstances of this case, the corporation had redeemed the stock within the meaning of Section 115 (g) of the Internal Revenue Code.

**STATUTE AND REGULATIONS INVOLVED**

Internal Revenue Code:

**SEC. 115. DISTRIBUTIONS BY CORPORATIONS.**

(a) *Definition of Dividend.*—The term "dividend" when used in this chapter (except in section 203 (a) (3) and section 207 (c) (1), relating to insurance companies) means any distribution made by a

corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(b) *Source of Distributions.*—For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113.

(c) *Distributions in Liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized

only to the extent provided in section 112. Despite the provisions of section 117, the gain so recognized shall be considered as a short-term capital gain, except in the case of amounts distributed in complete liquidation. \* \* \* In the case of amounts distributed (whether before January 1, 1939, or on or after such date) in partial liquidation (other than a distribution to which the provisions of subsection (h) of this section are applicable) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits. \* \* \*

\* \* \* \* \*

(g) *Redemption of Stock*.—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

\* \* \* \* \*

(i) *Definition of Partial Liquidation*.—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in

complete cancellation or redemption of all or a portion of its stock.

\* \* \* \* \*

(26 U. S. C. 115.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.115-9. *Distribution in redemption or cancellation of stock taxable as a dividend.*—\* \* \*

The question whether a distribution in connection with a cancellation or redemption of stock is essentially equivalent to the distribution of a taxable dividend depends upon the circumstances of each case. A cancellation or redemption by a corporation of a portion of its stock pro rata among all the shareholders will generally be considered as effecting a distribution essentially equivalent to a dividend distribution to the extent of the earnings and profits accumulated after February 28, 1913. On the other hand, a cancellation or redemption by a corporation of all of the stock of a particular shareholder, or that the shareholder ceases to be interested in the affairs of the corporation, does not effect a distribution of a taxable dividend. A bona fide distribution in complete cancellation or redemption of all of the stock of a corporation, or one of a series of bona fide distributions in complete cancellation or redemption of all of the stock of a corporation, is not essentially equivalent to the distribution of a taxable dividend. \* \* \* in all other

cases the facts and circumstances should be reported to the Commissioner for his determination whether the distribution, or any part thereof, is essentially equivalent to the distribution of a taxable dividend.

#### **STATEMENT**

The facts as found by the Tax Court (R. 170-171) may be summarized as follows:

The two taxpayers owned all the stock of Pedigree Fabrics, Inc., a corporation. In December, 1941, when Pedigree had earnings and profits of about \$185,000, it bought from each of the two taxpayers one-third of his stock for \$50,000. (R. 171). Thereafter each taxpayer continued to own one-half of the outstanding stock of Pedigree and Pedigree retained the stock as treasury stock. The Tax Court found that the purchase of the stock by Pedigree had no business purpose and that the object of the transaction, as well as the effect, was the distribution of a taxable dividend within the meaning of Section 115 (g) of the Internal Revenue Code. The taxpayers appealed to the court below, which affirmed the decision of the Tax Court.

#### **ARGUMENT**

1. The application of Section 115 (g) of the Internal Revenue Code and the corresponding provision of earlier Revenue Acts has generally been considered a question depending upon the

particular circumstances of each case.<sup>1</sup> The Treasury Regulations, which have been in effect for a great many years, expressly state that the question "depends upon the circumstances of each case." See Treasury Regulations 103, Section 19.115-9, *supra*. Consequently, in every instance that a petition for a writ of certiorari has been sought in a case involving Section 115 (g), this Court has denied the writ. *Commissioner v. Babson*, 70 F. 2d 304 (C. C. A. 7), certiorari denied, 293 U. S. 571; *Hyman v. Helvering*, 71 F. 2d 342 (App. D. C.), certiorari denied, 293 U. S. 570; *Randolph v. Commissioner*, 76 F. 2d 472 (C. C. A. 8), certiorari denied, 296 U. S. 599; *McGuire v. Commissioner*, 84 F. 2d 431 (C. C. A. 7), certiorari denied, 299 U. S. 591; *Commissioner v. Brown*, 69 F. 2d 602 (C. C. A. 7), certiorari denied, 293 U. S. 570.

Since the question is one of fact, the only question before the court below was whether there

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<sup>1</sup> *Commissioner v. Straub*, 76 F. 2d 388 (C. C. A. 3); *Commissioner v. Champion*, 78 F. 2d 513, 514 (C. C. A. 6); *Commissioner v. Cordingley*, 78 F. 2d 118, 120-121 (C. C. A. 1); *Brown v. Commissioner*, 79 F. 2d 73, 74 (C. C. A. 3); *Hill v. Commissioner*, 66 F. 2d 45 (C. C. A. 4); *Robinson v. Commissioner*, 69 F. 2d 972 (C. C. A. 5); *Commissioner v. Rockwood*, 82 F. 2d 359 (C. C. A. 7); *Hirsch v. Commissioner*, 124 F. 2d 24 (C. C. A. 9); *Flanagan v. Helvering*, 116 F. 2d 937 (App. D. C.); *Smith v. United States*, 121 F. 2d 692 (C. C. A. 3); *Vesper Co. v. Commissioner*, 131 F. 2d 200 (C. C. A. 8); *Bazley v. Commissioner*, 155 F. 2d 237 (C. C. A. 3), petition for a writ of certiorari pending, No. 287, this Term. See also cases cited in the text in which this Court denied certiorari.

was substantial evidence to support the decision of the Tax Court. The record shows that Pedigree acquired the same amount of stock from each of the two stockholders of the corporation and paid the same amount of money to each stockholder, namely, \$50,000; that petitioners continued to own the same proportion of the stock of the corporation, namely, one-half, after the corporation bought the stock. Furthermore, the corporation's balance sheet as of November 30, 1941 (the date of the purchase was December 20, 1941), shows surplus and net profit of more than \$193,000 (R. 136, 171) and the balance sheet as of December 31, 1941, shows a surplus of more than \$185,000 (R. 138, 171); and the business of Pedigree seemed to be expanding rather than diminishing in 1941, as shown by the fact that the net sales for the year ending May 31, 1941, were about \$2,800,000, and for the year ending May 31, 1942, they were about \$6,590,000. The net income of the corporation increased from about \$43,000 as of May 31, 1941, to about \$580,000 as of May 31, 1942. (R. 155.) No cash dividends were declared prior to 1943. We think that these facts constitute substantial support for the decisions of the Tax Court and of the court below.

Moreover, the facts of the instant case are strikingly similar to the illustration in the Congressional Committee Reports, when the antecedent of Section 115 (g) (Section 201 (g) of the Revenue Act of 1926) was first put in the Revenue

Act. The example is as follows: Assume that two men hold all the stock of a corporation for which each had paid \$50,000 in cash, and the corporation had accumulated a surplus of \$50,000 above its cash capital; and the corporation buys from each stockholder for cash one-half of his stock. The Committee Reports show that Congress attempted to make it clear that such a transaction should be taxed as a dividend.<sup>2</sup>

The petitioners rely upon the rule laid down by the court below in *Patty v. Helvering*, 98 F. 2d 717, 719, to the effect that "if redeemed shares have been issued bona fide, Section 115 (g) never applies." The court below decided that its decision in the *Patty* case was overruled in effect by the decision of this Court in *Commissioner v. Estate of Bedford*, 325 U. S. 283, reversing a decision of the court below, while the taxpayer insists that it was not overruled. (Br. 15.)

In the *Bedford* case this Court had under consideration a statute similar to Section 115 (g), namely, Section 112 (c) (2), which provides that where a cash distribution in connection with a statutory reorganization *has the effect of the distribution of a taxable dividend*, there shall be taxed as a dividend to each distributee such an amount of the gain recognized under Section 112 (c) (1) as is not in excess of his ratable share

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<sup>2</sup> H. Rep. 356, 69th Cong., 1st sess., p. 30. See also H. Rep. 1, 69th Cong., 1st sess., p. 5; S. Rep. 52, 69th Cong., 1st sess., p. 15.

of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The Tax Court held in the *Bedford* case that the cash distribution had the effect of the distribution of a taxable dividend within the meaning of Section 112 (c) (2); the court below reversed the Tax Court and held that the distribution was a partial liquidation within the meaning of Section 115 (i) and therefore came under the provisions of Section 112 (c) (1); this Court reversed the decision of the court below and upheld the decision of the Tax Court. Assuming that Section 112 (c) (2) and Section 115 (g) are substantially similar in regard to treating a distribution as the equivalent of a taxable dividend, although it is not in the form of a taxable dividend, and that the redeemed stock was issued bona fide in the *Bedford* case, there is no way of reconciling the result reached by this Court in the *Bedford* case with the rule of the court below in the *Patty* case, namely, if redeemed shares are issued bona fide, Section 115 (g) never applies. Therefore the effect of the decision of this Court in the *Bedford* case is to overrule the *Patty* case. Moreover, this Court indicated that it would apply the rule of *Dobson v. Commissioner*, 320 U. S. 489; if the case did not turn "on a generalizing principle." (325 U. S. at p. 292.) This holding would also seem to conflict with the view laid down by the court below in the *Patty* case that the application of Section 115 (g) rested upon a constitutive principle.

The petitioners argue that the decision of the court below is in direct conflict with *Commissioner v. Cordingley, supra*; *Malone v. Commissioner*, 128 F. 2d 967 (C. C. A. 5); and *Commissioner v. Brown, supra*, insofar as it holds that Section 115 (g) applies regardless of whether the original issuance of the stock redeemed was bona fide. (Br. 15.) We do not interpret the *Cordingley* or *Brown* cases or any other Circuit Court of Appeals decisions as having adopted the so-called constitutive principle laid down in the *Patty* case that Section 115 (g) never applies if the stock was issued bona fide. We think that the First and Seventh Circuits treated the question as one of fact. *Malone v. Commissioner, supra*, did not involve Section 115 (g).

2. This Court has said that the rule is well established that on questions of fact it accepts the findings in which two courts concur, unless clear error is shown. *Texas & N. O. R. Co. v. Railway Clerks*, 281 U. S. 548, 558. The petitioners contend that it was "clearly erroneous" for the Tax Court to decide that stock which was acquired by Pedigree and retained as treasury stock was redeemed within the meaning of Section 115 (g) of the Internal Revenue Code. The court below conceded that there was some authority to the effect that treasury shares were not redeemed, but held that the ruling "is not plainly enough wrong to allow us to displace the decision of the Tax Court." (R. 217.) See L. Hand, J., dissenting in

*Alpers v. Commissioner*, 126 F. 2d 58 (C. C. A. 2). We agree with the court below that the status of treasury shares is not made entirely clear in the books. Therefore, it could not reasonably be said that the holding of the Tax Court was clearly erroneous. Moreover, Section 115 (g) would be rendered totally ineffective if it did not apply where the corporation retained the stock as treasury stock.

The petitioners allege that the decision of the court below in this respect is in direct conflict with the decisions in *Amelia H. Cohen Trust v. Commissioner*, 121 F. 2d 689 (C. C. A. 3); *Britt v. Commissioner*, 114 F. 2d 10 (C. C. A. 4); and *Hill v. Commissioner*, 126 F. 2d 570 (C. C. A. 5).<sup>3</sup> (Pet. 5-6.) None of those cases involved the application of Section 115 (g); they dealt with the question whether an admitted gain on the sale of stock to a corporation was a capital gain

<sup>3</sup> Since 1942 this line of cases is not important because in that year Congress in Section 147 of the Revenue Act of 1942, c. 619, 56 Stat. 798, amended Section 115 (c) so that all gain derived from partial liquidation should be taxable at the capital gain rates. The reason given for such action as shown by the Congressional Committee Reports was that inequality resulted under the then existing law in the case of unquestionable bona fide redemptions of stock not equivalent in any way to the distribution of a taxable dividend and because it was believed that the proper application of Section 115 (g) would prove adequate to prevent taxable dividends disguised as liquidations from receiving capital gain treatment. S. Rep. 1631, 77th Cong., 2d sess., p. 116; H. Rep. 2333, 77th Cong., 2d sess., p. 93.

or ordinary gain, not whether the transaction was essentially equivalent to the distribution of a taxable dividend. It may be pointed out that the word "complete" precedes the words "cancellation or redemption" in Section 115 (i) but does not appear in Section 115 (g), and also that there are at least two court decisions in which Section 115 (g) was applied although the corporation held the reacquired stock as treasury stock. *Robinson v. Commissioner*, 69 F. 2d 972 (C. C. A. 5); *Fostoria Glass Co. v. Yoke*, 45 F. Supp. 962 (N. D. W. Va.). There are no cases as far as we can ascertain in which a court refused to apply Section 115 (g) because the reacquired stock was not immediately retired.

Assuming, however, that there was no redemption of stock within the meaning of Section 115 (g), we believe that the Tax Court and the court below reached the correct result, because the Tax Court found as a fact that no business purpose of the corporation was served by the transaction now in question. If that is so, we may disregard the transfer of stock certificates and treat the transaction as an outright distribution of a cash dividend within the meaning of Section 115 (a) and (b). See *Gregory v. Helvering*, 293 U. S. 465; *Commissioner v. Court Holding Co.*, 324 U. S. 331.

#### CONCLUSION

The decision of the court below is correct and there is no direct conflict of decisions. The con-

struction of Section 115 (g) upon which the petitioners rely was laid down in a decision of the court below which was in effect overruled by the decision of this Court in the *Bedford* case. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted.

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AUGUST 1946.